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How the Market Transition Affected Export Performance in the Central European Economies

Bartlomiej Kaminski

There appears to be a close link between export performance and the decision to move quickly to a market-based economy. Countries that removed administrative controls on prices, devalued currency, introduced unified exchange rates, and liberalized trade also expanded exports. The driving force of export growth in five Central and Eastern European countries was manufactures, some of them redirected from CMEA markets, primarily to Germany.

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This paper — a product of the International Trade Division, International Economics Department — is part of a larger effort in the department to analyze the transition from central planning to market-based economies. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Pauline Kokila, room S7-040, extension 33716 (September 1993, 38 pages).

Empirical studies have paid little attention to the supply-side forces behind the export performance of the Central and Eastern European countries of Bulgaria, Czechoslovakia, Hungary, Poland, and Romania (CEE-5) in OECD markets after the collapse of central planning.

Kaminski examines export developments in these countries in 1980-91, focusing on how transformation programs affected trade. OECD markets now receive three-fourths of CEE-5 exports. Sustaining this market penetration is crucial for countries making the transition to market-based economies. Kaminski provides insight into the impact of transformation-cum-stabilization programs on export performance. These insights are relevant to former centrally planned economies that have yet to restore macroeconomic equilibrium and to liberalize prices.

Kaminski examines the export performance of the CEE-5 before and after the collapse of central planning. He finds a close link between export performance and the decision to move quickly to a market-based economy. Countries that removed administrative controls on prices, devalued currency, introduced unified exchange rates, and liberalized trade also expanded exports. Bulgaria and Romania, crippled by macroeconomic chaos and vacillating macroeconomic reform, registered drops in both exports and imports.

Kaminski suggests that differences among Czechoslovakia, Hungary, and Poland (CEE-3) had little to do with previous trends in export performance, external economic factors, and earlier attempts at trade reform. The expansion of exports in 1990-92 represented a dramatic reversal of trends prevalent in the prior two decades. The surge in exports is explained neither by the length of time experimenting with foreign trade under central planning nor by earlier trends in competitiveness in OECD markets.

The driving force of export growth was manufactures, some of them redirected from CMEA markets, primarily to Germany. The severing of links that used to bind the economies of the CMEA had a less destructive impact on the foreign trade performance of the CEE-3 than one might have expected.

The fact that exports to the CMEA fell at the same time that exports elsewhere (often of the same products) increased suggests a causal relationship.

How the Market Transition Affected Export Performance in the Central European Economies

by

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I. INTRODUCTION

Assessing the export impact of the transformation of the post-communist countries is difficult. For the CEE-5 (Central European Economies: Bulgaria, Czechoslovakia, Hungary, Poland, and Romania) attributing change in export performance to a change in a particular policy variable is extremely complicated. First, all variables have been in a state of flux; next, in some cases too short a time has elapsed to make any generalizations; and finally, the quality of trade data is poor as national statistical offices have not kept pace with the expansion of the private sector and the move to a new customs system. Predicting the economic responses to a stabilization package in "socialist economies in transition" is a problem, too, since more than 90 percent of industrial output came from the state-owned sector, and organizational structures were designed to facilitate administrative management by the state rather than to respond to market signals.

In addition to its organizational legacies, central planning also left a legacy of production and investment patterns heavily distorted by the misallocation of resources. Development strategies were inward-oriented, with one exception--investment decisions in the smaller CPEs (centrally planned economies) were largely directed by the import requirements of the FSU (the former Soviet Union). The mismatch between the CPEs' production structure and demand in international markets resulted in their declining competitiveness in markets for manufactures. Consequently, although transformation programs may bring about the necessary changes in incentives and make enterprises responsive to external business opportunities, their capacity to compete internationally will be limited for some time because of outdated technologies. It is puzzling, therefore, to consider why manufactures were the driving force behind the export expansion to OECD markets from countries which implemented radical transformation programs.

The disintegration of the CMEA (Council for Mutual Economic Assistance[1]) inflicted a severe shock on all CMEA member economies, including the FSU which "..was hurt more than it gained" (ECE 1992:104). The sudden switch from the soft transferable ruble (TR) to the hard currency settlement mechanism, accompanied by the fall in Soviet oil output, changed dramatically the external position of the former CMEA economies. Sectors that had been developed to serve the intra-CMEA division of labor have faced a major contraction in demand for their products. These sectors, together with those established for political rather than economic reasons, accounted for a considerable portion of the industrial output of the former CMEA region. This paper addresses the question of the extent to which the contraction in intra-CMEA trade resulted in the switching of exports from the CMEA toward the OECD.

The size of the export sector in overall economic activity has significantly increased in only the three most reformed countries (CEE-3)--the FCSK (the former Czechoslovakia), Hungary and Poland. This

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[1] The CMEA was officially dissolved at its 46th general meeting on June 28, 1991. Its members included Bulgaria, Cuba, Czechoslovakia, German Democratic Republic, Hungary, Mongolia, Poland, Romania, Soviet Union and Vietnam.

increased share has been due to both the continued contraction of GDP (and an even larger contraction in industrial output) and the expansion of exports to the OECD. Available evidence suggests that the export expansion in OECD markets was to some extent propelled by redirection of sales from the CMEA. The decline in the value of intra-CMEA exports was in absolute terms equal to the increase in exports to the OECD, especially in the case of the most reformed CEE-3 economies.

The sustainability of the change in the trade pattern is unsure. For the short term, the export expansion appears to be sustainable--the drop in domestic demand, the improved access to OECD markets, the liberalization of foreign trade regimes, and the move toward convertibility of domestic currencies have provided a strong stimulus to firms to look for external markets for their products. Medium- to long-term prospects, however, remain uncertain. The fall in investment and industrial output so far has not been reversed-- not one country in Central Europe has shown signs of recovery, with the possible exception of Hungary and Poland in 1992. With the general contraction in investment and the continued ambivalence in the situation of SOEs (state-owned enterprises), there is a danger that even so-far successful export-oriented SOEs may refrain from investments. Further constraints to investment include the poorly developed banking sector, the lack of institutional infrastructure supporting foreign trade, and ambiguities in property rights and in the organizational status of many SOEs. Moreover, the shift of resources to the ex sector may be less than it would be with profit-oriented firms.[2] If SOEs use export proceeds to increase wages rather than profits, a likely development in labor-managed SOEs, their future competitiveness may be jeopardized. In the longer run, a sustained export performance and integration with the world economy will depend on many factors including macroeconomic policies, exchange rate policy, foreign direct investment inflows and domestic savings, as well as on the development of an institutional environment enhancing microeconomic efficiency.

This paper addresses the question of the impact of the market transition on the export performance of Central European economies by taking a broad look at developments both in the foreign trade regimes of the CEE-5 and their export performance in OECD markets. It begins by assessing where these economies are in terms of institutional change in their foreign trade regimes. It then provides an overview of export performance of the CEE-5 in OECD markets in the 1980-91 period, specifically addressing the issue of the impact of moving to a market economy. It shows that an increase in penetration of OECD market was driven by the change in domestic economic systems rather than by external factors such as the breakdown of the CMEA or the emergence of cooperative economic relations between the CEE-5 and OECD economies. Following the collapse of central planning, OECD governments introduced measures improving market access

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[2] Without a detailed analysis of capital investments disaggregated to the level of firms, it is impossible to assess the extent to which the structure of exports keeps on being regenerated.

for the CEE-5. It is argued, however, that GSP (General System of Preferences) status granted by the EC to Hungary and Poland (effective in 1990), increased EC quotas for textiles and clothing or MFN status in the United States do not provide a full explanation of the increase in exports. The export performance of the Central European "troika"--the FCSK, Hungary and Poland--was particularly impressive in the 1990-91 period, when a long-term trend of progressive marginalization in OECD markets, especially for manufactured goods, was reversed. Is this the beginning of a new trend to expanding integration with the world economy? This question is addressed only tangentially; more research is needed on the anatomy of the export upswing following the collapse of central planning.

II. LIMITS TO CHANGES IN FOREIGN TRADE REGIMES UNDER CENTRAL PLANNING

The reform of foreign trade regimes began well before the collapse of the CEE-5 communist governments in 1989 and 1990. In fact, foreign trade was an area where much policy experimentation had taken place in the 1980s. The general approach taken by communist reformers included linking domestic prices to international prices; establishing direct links between enterprises and international markets, bypassing the traditional foreign trade organizations; establishing a larger number of intermediaries with a less restricted trading profile; introducing currency auctions; and reducing the number of exchange rates and devaluing them to more realistic levels. While these measures contributed to a proliferation of marketing expertise at the level of enterprises and provided incentives to boost exports, they failed to introduce "... market clearing at single prices without *ex post* and *ad hoc* subsidies and levies, yielding a profit which is retained by enterprises or losses which penalize them"(Nuti 1991:50).

Thus, no matter how radical the reform measures were, foreign trade regimes under central planning remained a source of enormous distortions and inefficiencies, insulating domestic producers from the impact of changes in relative prices in world markets and falling short of making foreign trade an effective conveyor of international efficiency standards. What was needed to achieve this end was: the removal of anti-export biases such as import restrictions, administrative allocation of raw materials and foreign exchange, and price controls; the dismantling of administrative mechanisms designed to encourage exports and discourage imports; and the elimination of "soft-budgets" for enterprises (so that inefficient producers would be penalized). However, these changes were not possible without abandoning central planning.

Before the collapse of communism, the decentralization of foreign trade regimes made most progress in Hungary and Poland--they were both highly indebted to the West and were the first to seek to orient their economies away from the CMEA (Hillman and Schnytzer, 1992:253). With the decline of the Soviet capability to sustain intra-CMEA trade in the late 1980s, other CEE-5 countries undertook foreign trade reforms but these were less comprehensive than those of Hungary and Poland. Foreign trade reforms shared two sets of features. The first

set included allowing SOEs to conduct foreign trade, thus eroding the state monopoly of foreign trade. For instance, in 1986 the Hungarian government adopted the principle of "parallel" trade licenses. Trade licenses were no longer granted exclusively to dominant exporters and importers. They were made available to all firms and covered most products. As a result, the number of firms operating in international markets dramatically increased by the end of the 1980s.[3] In Poland, significant steps to dismantle the state monopoly of foreign trade were undertaken in the early 1980s when the authorities liberalized conditions to obtain foreign trade licenses. Between 1982 and 1985, the number of SOEs empowered to conduct foreign trade operations increased from 109 to 361. By the end of the 1980s, the state monopoly was abrogated (Olechowski and Oles, 1991:156 and 158).

The second set of features of foreign trade reforms included creating incentives for SOEs to expand exports through hard currency retention schemes and exchange rate policy. The latter consisted essentially of a series of devaluations towards more realistic rates. Between 1980 and 1985, the Polish real exchange rate depreciated by 30 percent, and the Hungarian rate by 11 percent (Roe and Roy, 1989:6). The exchange rate policy had a more significant impact on export performance once SOEs were allowed to retain some portion of their foreign exchange earnings. Polish exporters who were allowed to retain 25-30 percent of their foreign exchange earnings responded to a substantial devaluation of the Polish zloty in late 1987 by increasing exports--the 17.4 percent increase in convertible currency exports in 1988 was attributable to the devaluation (Winiecki, 1991). Retention schemes amounted to limited convertibility. In Hungary the 1989 import liberalization package comprising about 35 percent (subsequently extended in 1990 to include 65-70 percent) of Hungary's hard-currency imports, combined with joint-ventures laws allowing profit repatriation abroad, introduced a limited convertibility to Hungarian currency.

While these changes in the foreign trade regimes reduced the insulation of enterprises from international markets, almost full protection of SOEs from international competition was retained.[4] Not even in Hungary or Poland did the trade regime offer any clue as to whether domestically-profitable operations had a positive or negative value added at world prices. Nonetheless, as we shall see, the export performance of Hungary and Poland in OECD markets was significantly better than that of other CEE-5 economies, suggesting the existence of a positive link between foreign trade reforms and export performance.

In other CEE-5 countries, with the exception of Romania, there was also a lot of activity in foreign trade policy but little that was effective. The currency was devalued in the FCSK (by 19 percent in 1989) and in Bulgaria (by a factor of 12 in 1989!). Bulgarian exporters were allowed to retain 60 percent of their export earnings. Auctions of foreign currency were organized in Bulgaria and the FCSK. These measures had a more limited impact on foreign trade than similar measures in Hungary and Poland for one major reason: SOEs in Bulgaria and the

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[3] For a review, see Mizsei (1991:15-20).

[4] For a brief discussion of the Polish foreign trade regime in the late 1980s, see World Bank, Poland: Economic Management for A New Era (1990).

FCSK were much more administrative units of the state than their counterparts in Hungary and Poland. Even so, SOEs in all CEE-5 economies operated in an administrative environment devoid of competition, market clearing prices, freedom of entry, and a final penalty for poor performance, i.e., bankruptcy. For all, foreign trade equalization schemes provided a buffer between domestic producers and world prices.

The major lesson that can be drawn from these attempted reforms of foreign trade regimes under central planning is that their impact on export performance and competitiveness was limited while an administrative economic system remained. With the collapse of the communist regimes it became politically possible to dismantle central planning (or whatever was left of it) and establish an economic system based on market-clearing prices and competition among autonomous economic units. However, the results of the collapse of communism varied with the pace of "system replacement" pursued in different CEE-5 countries. Hungary followed a "shock minimization" approach, Poland and the FCSK adopted radical programs in January 1990 and 1991 respectively, and two latecomers, Bulgaria and Romania, began introducing reform measures throughout 1991 and early 1992. As we shall see, the different paces reflected to some degree earlier expressed attitudes towards reform.

III. CEE-5 EXPORTS TO THE OECD IN THE 1980s: THE INITIAL BREAKDOWN AND GROWING MARGINALIZATION

This section provides background for the assessment of export performance of the CEE-5 economies following the collapse of communism. Since the objective is to identify major trends in their competitive position between 1980 and 1989, and to assess the degree to which their export performance in 1990-91 represented a break with the past, the analysis in this section is limited to the following broad commodity categories: foods and feeds (SITC Rev.2. 0+1+22+4); raw materials (SITC Rev.2. 2-22-27-28); mineral fuels (SITC Rev.2. 3); ores and metals (SITC Rev.2. 27+28+68); and manufactures (SITC. Rev. 2. 5+6+7+8-68). In order to minimize well-known problems concerning the quality of statistical information from this region, the analysis of CEE-5 export performance in OECD markets is based on import data of OECD countries. The analysis covers European and North American OECD members and Japan.[5]

A. An Overview of Major Tendencies in Export Performance

No matter how vigorously the various communist governments pursued reform policies the foreign trade performance of individual countries revealed disturbing similarities. First, despite governments' efforts to reverse declining competitiveness evident in the 1970s (Poznanski, 1988), the competitive position of all CEE-5 countries in OECD markets dropped significantly further in the 1980s. The competitive position of all CEE-5 economies,

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[5] The analysis does not cover all OECD members. It includes ten members of the European Communities (i.e., excluding Greece and Portugal), all members of the European Free Trade Association (Austria, Finland, Iceland, Norway, Sweden and Switzerland), North America (USA and Canada), and Japan.

as measured by annual changes in their shares in total imports of OECD countries, fell each year in the 1980s except in 1984.[6] Their average annual export growth rate was 2.9 percent while the average for all OECD imports was 5.6 percent in 1981-89. As can be seen from Table 1, the CEE-5 share in total OECD imports fell from 1.1 percent in 1980 to 0.9 percent in 1989: in 1989 the region's total exports to the OECD stood at three quarters of their 1980 level.

Table 1: Share of CEE-5 in Total Imports of OECD, by Major Product Categories, 1980-89

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Foods and Feeds	1.5	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.6	1.6	1.6
Mineral Fuels	1.0	0.8	0.8	1.0	1.3	1.3	1.6	1.6	1.5	1.3	0.9	0.8
Ores & Nonferrous Metals	1.4	1.2	1.3	1.1	1.4	1.4	1.3	1.3	1.4	1.2	1.3	1.7
Raw Materials	1.8	1.7	1.7	1.7	1.7	1.8	1.9	1.7	1.6	1.4	1.5	1.5
Manufactures	1.1	1.0	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.8	0.9
Total Imports	1.15	0.99	0.95	0.95	1.02	0.98	0.95	0.94	0.90	0.88	0.91	1.02

Source: Derived from the United Nations COMTRADE data base.

The shares of Bulgaria, the FCSK and Poland in total OECD imports reached their peak in 1980, and Roman peak was in 1984 (at the height of Ceaucescu's policy of paying off the external debt, which eventually destroyed the Romanian economy). Hungary, which revived its reform effort after joining the IMF and the World Bank in 1982, failed to noticeably improve its competitive position between 1980 and 1989. The two Balkan countries experienced the largest deterioration in export performance in the 1980s: in 1989 Bulgaria's share stood at 57.3 percent and Romania's at 58.8 percent of their respective peak performance years. A smaller loss of OECD market share was experienced by the FCSK, whose share in 1989 was 80.5 percent of its 1980 level, and Poland, whose 1989 share was 69.6 percent of its 1980 level.[7]

The second disturbing trend for the CEE-5 economies was the growing marginalization of CEE-5 suppliers in OECD markets in the 1980s. This was manifest not only in falling shares in OECD imports but also in large annual fluctuations in their exports, revealing their high vulnerability to swings in OECD business cycles, especially during periods of recession. The cyclical contraction in OECD import demand for CEE-5 products tended to be larger than for exports from other countries with two notable exceptions: ores and nonferrous metals and mineral fuels. The considerable annual fluctuations in CEE-5 exports to the OECD in the 1980s also testified to their lack of long-term commercial contact. The range of variation was smaller for

[6] This temporary improvement was mainly due to a one-time increase in Romanian exports across all major product categories. However, subsequent years witnessed a dramatic contraction in Romanian exports.

[7] Some countries fared slightly better in EC markets: the decline in the EC import share of Czecho-Slovakia, Poland and Romania was lower than for other OECD markets.

exports to the EC than to other OECD partners, although the latter's share in CEE-5 exports increased in the 1980s.[8]

The third cause of concern for the CEE-5 was that the region's comparative advantage remained in food and natural resource-intensive products, as revealed in its exports to OECD markets (see Table 3). Further, its position as a marginal supplier of resource-intensive products became increasingly apparent throughout the 1980s, reflecting the rapidly expanding technological gap between East and West. The region's competitive position improved in mineral fuels only. In other markets, the CEE-5 lost shares to more competitive suppliers. Although the average rate of growth of shares of the CEE-5 in OECD imports of ores and nonferrous metals and raw materials fell in the 1981-89 period, the contraction was smaller than in total imports, revealing these countries' continued specialization in low value-added, resource-intensive production.

The key points evident from the data in Table 2 are that while CEE-5 exports to the OECD grew across most commodity groups, their shares of OECD markets tended to decline, and that this fall in market share was greatest in manufactures (in 1989, manufactures' share was 62.6 percent of its peak level in 1980). Hungary's distinctive decline in manufactures' exports to the OECD was part of a general shift away from manufactures in both OECD market shares and export revenue composition.

Other interesting points to emerge from Table 2 are the growing importance of agricultural products in the export revenues of the FCSK and Poland, of raw materials in the export revenues of Bulgaria, and of ores and nonferrous metals for Romania. Also notable is the fact that Poland's and Bulgaria's shares of OECD markets for ores and nonferrous metals displayed a negative trend throughout the 1980s.

Table 2: Growth Rates of (A) CEE-5 Exports to the OECD, by commodity groups, and (B) Changes in Shares of CEE-5 Exports in OECD Imports, by commodity groups (1981-1989, percent)

	CEE-5		Bulgaria		Czechoslovakia		Hungary		Poland		Romania	
	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)
Foods and Feeds	2.1	-0.5	2.6	-2.2	4.8	3.8	-0.2	1.2	4.5	2.7	-5.8	-8.6
Mineral Fuels	-3.9	4.8	-4.1	1.3	-5.1	3.5	3.4	8.9	-3.5	5.7	-1.5	8.0
Ores&Nonferrous Metals	0.4	-0.5	1.3	-4.9	3.5	2.9	2.8	4.9	-1.7	-3.4	17.4	15.6
Raw Materials	6.2	-1.5	10.3	4.2	-1.4	-2.0	1.8	3.6	-2.9	-5.3	-5.8	-11.2
Manufactures	1.4	-5.0	1.0	-8.3	0.8	-5.0	-0.1	-3.3	2.4	-4.8	2.5	-5.8

Source: See Table 1.

[8] EC-10's share fell from around 70 percent in the 1980-83 period to an average of 68 percent in the 1984-89 period. The share of EC-10 increased slightly for only two countries between the two periods: Czechoslovakia (from 67.2 percent to 68.4 percent) and Poland (from 68.5 percent to 70.3 percent). These increases were too small to offset the reorientation of Hungary's exports (from 68.3 percent to 63 percent) and Romania's exports (from 72 percent to 68 percent) (Calculated from the UN COMTRADE data base).

The decline was particularly surprising in the case of the Central European troika.[9] The FCSK, once a renowned exporter of machine tools and other high quality industrial products, became increasingly specialized in agricultural products and ores and nonferrous metals. Poland, thanks to Western credits, had a relatively modern industrial base on the eve of the 1980s, but experienced the second largest loss among the CEE-5 in share of OECD markets for manufactured products. Hence its investment drive in the 1970s had no discernible impact on its international competitive position. Hungary, a country much praised for its reform efforts in the 1980s, tended to shift away from manufactures and food products to minerals and raw materials, although its relative competitive position fell the least among the CEE-5 in the 1981-89 period.

B. Two Distinct Phases: Breakdown and Precarious Recovery

An examination of the CEE-5 OECD export performance in the 1980s suggests the existence of two distinct periods. The first, between 1980 and 1983, can be called a "breakdown" period; the contraction in OECD import demand resulted in a much larger fall in exports from the CEE-5. The second, between 1984 and 1989, can be described as a period of stagnation and "progressive marginalization" of the CEE-5 region in OECD markets. Despite the expanding import demand in OECD countries, especially for manufactured products, communist governments' efforts to boost exports produced ....ited results.

The first period coincided with OECD recession and with deterioration in East-West political relations. Total OECD imports fell at an annual average rate of around 4 percent in the 1981-84 period, reaching their lowest point in 1982 when they fell by 6.2 percent. However, the fall in CEE-5 exports was significantly larger than the decline in OECD import demand overall.[10] The latter fell by around 12 percent in aggregate over this period, while CEE-5 exports declined by nearly 30 percent.

As can be seen from Table 3, during 1981-83 all exports with the exception of mineral fuels contracted much more than OECD imports. The most affected were manufactures: the ratio of the average annual (negative) growth rate of CEE-5 exports to the OECD import (negative) growth rate was 7.12. There were only a few bright spots: all CEE-5 economies recorded a lower fall in exports of mineral fuels (as a result, their market shares for fuels increased); Czechoslovak exports of agricultural products increased; Hungary substantially expanded its exports of raw materials and mineral fuels; and Romania increased its exports of ores and nonferrous metals. Bulgaria's and especially Poland's exports collapsed in all product

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[9] The worst performer was Bulgaria, whose share in 1989 in total OECD imports of manufactured goods was 55.3 percent lower than in the peak year of 1980. Romania's share dropped by 41 percent in comparison with its peak year in 1980, Poland's by 40.4 percent, Czechoslovakia's by 27 percent, and Hungary's by 28.3 percent.

[10] For this reason, the data for 1983 or 1984 is used as the base in the inter-temporal comparative analysis.

categories except for mineral fuels.

While the fall in CEE-5 exports to the OECD in the early 1980s was attributed to the recession in the OECD and the deterioration in East-West political relations,[11] in the second half of the 1980s East-West relations ceased to be an active constraint on commercial relations. Yet CEE-5 exports did not recover.

By the end of the 1980s, despite domestic political pressures to expand exports to obtain much-needed hard currency, CEE-5 exporters failed to recapture the losses in market shares that they had suffered during the breakdown period. As can be seen from Table 3, the growth in the total exports of CEE-5 fell behind that of total OECD import demand on average by around 12 percent annually, mainly because of poor performance in manufactures exports. The CEE-5 region improved its position in OECD markets vis-a-vis other competitors in food, mineral fuels and metals, with the highest ratio being for mineral fuels; OECD import demand was falling at an annual average rate of 3.2 percent, while exports from the CEE-5 were increasing by 1 percent per annum. Agricultural and ores/nonferrous metals exports also increased at rates higher than the growth in import demand. Both of these product categories had registered a significant loss in OECD market shares during the breakdown period, but both subsequently regained their 1980 market share. Hungary and Poland increased their presence in OECD markets, while Bulgaria's and Romania's shares fell precipitously in the second period. The FCSK also experienced a loss in market share, though a smaller loss than the two Balkan countries.

Hungary's and Poland's export performance stands out. Their efforts to reform their trading regimes and expand their trade links with the OECD, both precipitated by significant sovereign debt accrued in the 1970s, were impressive by CEE-5 standards, though not by the standards of other exporters. While their shares in total CEE-5 exports fell during the breakdown period, it increased significantly in the second period--from 49 percent in 1983 to 56 percent in 1989. Poland retained its position as the largest CEE-5 exporter to the OECD (32 percent in 1989), while Hungary became the second largest exporter (24 percent in 1989); the shares of the FCSK and Romania fell from 23 to 21 percent and 23 to 19 percent, respectively, between 1983 and 1989.

The move toward the status of a supplier of nonrenewable, natural resource-intensive products was most pronounced for the FCSK and the Balkan countries and least for Hungary and Poland. Hungary and

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[11] Relations were especially adversarial in the early 1980s following the Soviet invasion of Afghanistan in December 1979 and the imposition of martial law in Poland in December of 1981. One of the largest declines was in Polish exports during the Solidarity period in 1981. Polish exports, which accounted for about 35 percent of the CEE-5 total, fell by 35 percent in 1981.

Poland increased their share in CEE-5 exports of manufactures, with Poland registering the largest increase.[12] Poland took Hungary's position as the largest exporter of agricultural products: its share rose from 35 percent in 1984 to 41 percent in 1989, while Hungary's share fell from 37 percent to 35 percent. The FCSK increased its dominance as the largest exporter of raw materials and increased its share in all product categories except manufactures. Romania's share declined steeply in all product categories except ores and nonferrous metals. So did Bulgaria's share, with the exception of raw materials.

Table 3: Ratios of CEE-5 Export Growth Rates to OECD Import Growth Rates by Product Categories, 1981-83 to 1990-91

	1981-83	1984-89	1990-91	1981-83	1984-89	1990-91
	CEE-5			Bulgaria		
Foods and Feeds	2.35*	1.42	1.14	2.15*	0.82	.73
Mineral Fuels	0.74*	-0.30*	-0.98	0.20*	1.67*	(-3.89)
Ores and Non-Ferrous Metals	1.46*	1.19	-4.07*	2.26*	1.02*	-15.98*
Raw Materials	1.31*	0.70	-0.77*	1.03*	1.68	4.44*
Manufactures	7.12*	0.80	2.72	9.28*	0.56	2.30
Total Exports	2.31*	0.88	1.87	2.46*	0.43	1.54
	Czechoslovakia			Hungary		
Foods and Feeds	*	1.47	0.85	1.40*	1.31	1.42
Mineral Fuels	*	0.04*	(-0.73)	-1.74*	-1.97*	0.60
Ores and Non-Ferrous Metals	0.44*	1.11	-17.20*	0.73*	1.51	-0.51*
Raw Materials	1.00*	0.66	3.25*	-0.31*	0.97	-4.53*
Manufactures	4.18*	0.63	3.80	5.12*	0.86	2.97
Total Exports	1.48*	0.76	2.92	1.31*	1.09	2.37
	Poland			Romania		
Foods and Feeds	2.68*	1.88	1.26	5.14*	0.32	0.91
Mineral Fuels	0.53*	-0.09*	1.14	0.10*	-1.16*	(-4.13)
Ores and Non-Ferrous Metals	1.83*	0.98	-6.95*	-1.31*	2.42	11.61*
Raw Materials	2.00*	0.62	-6.11*	2.42*	0.44	11.39*
Manufactures	13.52*	1.23	4.10	4.36*	0.63	(-1.11)
Total Exports	3.64*	1.12	3.09	1.56*	0.67	(-2.56)

Note: * denotes negative growth rates in OECD imports;
(-) denotes a negative growth rate of CEE-5 exports.

Source: See Table 1.

The regional composition of CEE-5 aggregate exports to OECD economies remained relatively stable throughout the 1980s. The shares going to the EC-10 (68 percent) and the EFTA (18 percent) declined slightly between the two periods, while the shares going to other OECD countries increased slightly. These changes were the result of the redirection of exports away from Europe by Hungary and Romania.

[12] Poland's share rose from 21 to 27 percent between 1984 and 1989, while Hungary's share increased from 21 to 24 percent. The FCSK, which remained the second largest exporter of manufactures in the CEE-5 region in the 1984-89 period, registered a fall from 26 to 25 percent.

The picture that emerges from this analysis can be summarized as follows: (i) the export performance of the CEE-5 was very unimpressive in the 1980s despite efforts at reforming foreign trade regimes under central planning; (ii) the decline in their competitive position in OECD markets, already observed in the 1970s, continued through the 1980s; (iii) the contraction in their presence in OECD markets, particularly notable in the early 1980s, was not reversed; (iv) their exports were extremely vulnerable to changes in OECD import demand; (v) the commodity composition of exports shifted toward low value-added, resource-intensive products; and (vi) the role of OECD countries other than the EC-10 and EFTA remained marginal for the CEE-5 except for Romania. The symptoms of a deep structural crisis were clearly visible in their export performance in the OECD. Against this dismal overall picture, the export performance of the two most reformed CPEs, Hungary and Poland, was significantly better.

IV. THE EXPORT UPSWING: IN DEFIANCE OF PAST TRENDS

The extrapolation of export trends characteristic of the 1984-89 period would yield the following predictions for the CEE-5 in the 1990s: the region's share in OECD exports would continue slipping, especially in manufactures; their export profile would continue moving to agricultural products and nonrenewable natural resources; Poland's and Hungary's position among the CEE-5 would continue improving although at an uneven pace; the FCSK's relative position would continue declining, albeit at a slower rate than that of Bulgaria and Romania; the weight of the latter two countries in CEE-5 exports and OECD imports would continue shrinking; and the reliance on EC-10 markets would slowly increase. In addition, the contraction in investment activity throughout the region in the 1980s and the poor match between its investment/production patterns and international markets would give extra credibility to the forecast of no significant improvement in export performance in the 1990s. With these expectations, the designers of the Polish stabilization-cum-adjustment program assumed only a slight increase of hard currency exports (Kolodko, 1991:13). Yet 1990, the first year after the collapse of communist regimes, proved to be a turning point in the region's export performance in the OECD, initially especially because of Polish export expansion. Appendix Table 1 summarizes information on the export upswing in 1990 and 1991.

A. Challenging the Projections

The developments in CEE-5 export performance in the period immediately following the collapse of central planning defied some and confirmed other aspects of predictions based on trends dominant in the 1980s. While the 1990 and 1991 improvement in the relative position of Hungary and Poland, both among CEE-5 exporters and in OECD markets, and the deterioration of the export performance of the two Balkan

countries came as no surprise, the pace at which exports of Bulgaria and Romania fell in 1990 and those of Hungary and Poland rose defied all predictions. Between 1984-89 and 1990-91, the share of Bulgaria and Romania in CEE-5 exports fell from 28 percent to below 14 percent, mostly because of the collapse of exports of oil and manufactured products. At the same time, the share of Hungary and Poland in total CEE-5 exports to the OECD increased from around 51 percent in the 1984-89 period to 64 percent in the 1990-91 period, mainly because of the expansion of manufactured exports.

Contrary to expectations, the share of the region in total OECD import demand increased in both 1990 and 1991 thanks to export expansion by the Central European troika whose share in CEE-5 exports increased from an average of 72 percent in the 1984-89 period to 80 percent in 1991. The increase was mainly the result of the reversal of two trends--stagnating Czechoslovak exports and declining regional competitiveness in manufactures. The FCSK's exports soared in 1991 (see column b of Appendix Table 1), and the share of CEE-5 manufactures in OECD imports increased in both 1990 and 1991. Since the shares in OECD markets for raw materials and especially for foods and feeds and ores and nonferrous metals also increased, while that for mineral fuels and raw materials contracted, the region's export profile continued to be characterized by a heavy reliance on natural resource-intensive products, though it has been somewhat attenuated (see Table 1).

B. Reforms Make a Difference

The developments in CEE-5 export performance in the 1990-91 period sharpened the differences between the most reformed economies of the Central European troika (the CEE-3) and the Balkan countries (Bulgaria and Romania). The latter group was not only marginalized vis-a-vis the CEE-3 in OECD markets, but its export profile shifted towards low value-added products.

The collapse of Romania's exports in 1990 and 1991 reflected the acceleration of a tendency that began in the mid-1980s. In 1991, the value of Romanian exports to the OECD was almost 50 percent lower than in 1987. By comparison, Czechoslovak, Hungarian and Polish exports expanded at double digit growth rates in 1990 and 1991. Contrary to expectations, the driving force of the troika export boom in OECD markets was manufactures. Their share in OECD manufactures import demand, though still insignificant, increased by 41 percent from an average of 0.5 percent in 1984-89 to 0.7 percent in 1990-91.

As Table 4 shows, manufactures accounted for 80 percent of the increase in the value of total exports of the CEE-3 between 1989 and 1991. Exports of manufactures accounted for more than 100 percent of the increase in Czechoslovak exports in 1990 and for 96 percent of the increase for 1990 and 1991 together. A detailed account of manufactured goods' success stories in OECD markets has not been developed so far. However, a summary examination of Polish data suggests that important items in the Polish export drive

included garments, chemicals (organic and inorganic, polymerization products, wood- and resin-based chemical products), paper and products of paper, textile yarns, non-metallic mineral manufactures (cement, lime, fabricated construction materials, mineral manufactures, glassware, pottery), iron and steel products (pig iron, ingots, rails), manufactures of metal (hangars, household equipment of base metals), specialized machinery (machine tools), mechanical handling equipment (cranes, works trucks), household type electrical and non-electrical equipment, non-motorized trailer and other vehicles, and ships and boats.[13] At first glance, it seems that no major shift in revealed comparative advantage for manufactures occurred in the 1989-91 period as compared with the 1984-89 period.

Table 4: The Role of Manufactures in the OECD Export Growth of CEE-3, 1989 to 1991

	Value (mill. US$)			Increase in value (mill. US$)		Share of Manufactures in Increase in Total Exports (in percent)	
	1989	1990	1991	1989-90	1990-91	1989-90	1990-91
Czechoslovakia							
Total Exports	3924	4585	6270	661	1685	----	----
Exports of Manufactures	2545	3218	4788	673	1570	102	93
Hungary							
Total Exports	4359	5511	6451	1152	940	----	----
Exports of Manufactures	2420	3347	4035	927	686	81	73
Poland							
Total Export	5879	8436	9546	2557	1110	----	----
Exports of Manufactures	2771	4390	5388	1619	998	63	90
Total CEE-3							
Total Exports	14162	18531	22268	4369	3737	----	----
Exports of Manufactures	7736	10955	14210	3219	3255	74	80

SOURCE: See Table 1

The increase in CEE-3 exports is truly astounding considering their export performance and investment policies in the 1980s, the fact that SOEs were mainly responsible for the increased exports of manufactures, and also that the CEE-3 did not have export supporting institutions similar to Hermes in Germany or Ex-Im Bank in the United States. More detailed analysis is warranted.

C. Germany: Locomotive of CEE-5 Export Growth

During the export growth of 1990-91, the geographic pattern of CEE-5 exports changed, with a movement towards European markets in general and Germany in particular. The shift of CEE-5 exports to the EC-10 began in the late 1980s and was amplified in the 1990-91 period; the share of the EC-10 in CEE-5

[13] For a detailed analysis, see Kaminski, 1993:7-8.

total exports increased from 68 percent in 1984-89 to 73 percent in 1990 and to 77 percent in 1991. The main engine of CEE-5 export growth was Germany (see Table 5)--excluding Germany, the EC markets for Central European products stagnated in 1991. The share of Germany in CEE-5 exports to the EC-10 substantially increased for all countries except Hungary, and the share of Germany in total OECD imports from the CEE-5 increased between 1989 and 1990 by almost 50 percent--from 34 percent to 49 percent.

Table 5: The Role of Germany in the Export Growth of CEE-5 in 1990 and 1991

A. Share of Germany in OECD and EC-10 Imports from the CEE-5 (in percent)

	Bulgaria			Czechoslovakia			Hungary		
	1989	1990	1991	1989	1990	1991	1989	1990	1991
OECD	23	27	33	34	37	49	33	37	40
EC-10	32	35	42	43	51	63	55	55	58

	Poland			Romania			CEE-3		
	1989	1990	1991	1989	1990	1991	1989	1990	1991
OECD	32	38	52	14	28	36	33	37	45
EC-10	46	50	58	20	37	42	47	52	59

B. Annual Increases in Value of Imports from CEE countries (mill. US$)

	Bulgaria		Czechoslovakia		Hungary	
	1990	1991	1990	1991	1990	1991
Germany	72	76	355	1388	598	553
EC-9 (Germany excluded)	76	-10	196	240	306	197
Other OECD	19	-9	110	58	249	190
Memorandum: Share of the increase in OECD imports absorbed by Germany (in percent)	43	134	54	82	52	59

	Poland		Romania		CEE-3	
	1990	1991	1990	1991	1990	1991
Germany	1320	1147	-127	40	2273	3088
EC-9 (Germany excluded)	928	8	-658	-186	1431	445
Other OECD	308	-44	-312	-240	667	203
Memorandum: Share of the increase in OECD imports absorbed by Germany (in percent)	52	103	--	--	52	83

Source: See Table 1

Although Germany has been traditionally the largest OECD trading partner of Central Europe, its significance increased for each of the CEE-5 economies in 1990 and 1991. The share of Germany in OECD imports from Romania surged from 14 percent in 1989 to 52 percent in 1991, mainly because exports to Germany fell less than to other partners in 1990 and they actually increased in 1991. For Bulgaria, the increase in sales to German firms more than offset the contraction of other OECD markets in 1991. German

markets absorbed about 54 percent of the increase in exports from the FCSK in 1990, and 82 percent of this increase in 1991. As a result, the share of Germany in Czechoslovak exports increased by 15 percentage points between 1989 and 1991. The German share in Hungarian exports to the OECD was slightly lower than that of other CEE-5 countries, but Germany took three quarters of the increase in Hungarian exports to the EC in 1991. Poland reoriented its exports to Germany in a dramatic fashion in 1991: its exports in current prices to EFTA, North America and Japan contracted, to other EC-9 countries stagnated, but to Germany grew by more than US$1 billion. Germany's share in OECD exports of the troika increased from 33 percent in 1989 to 45 percent in 1991.

Moreover, Germany's share in CEE-5 exports to the EC-10 increased significantly in nearly all major product categories. The only exceptions were ores and nonferrous metals for Czechoslovak, Hungarian and Romanian exports and raw materials for Hungarian and Romanian exports. The largest increases in Germany's share in exports to the EC were: for Bulgaria, mineral fuels (from 7.5 percent in 1989 to 62.2 percent in 1991) and raw materials (18.3 percent to 36 percent); for the FCSK, manufactures (43.4 percent to 61.5 percent) and agricultural products (55.8 percent to 69.6 percent); for Hungary, agricultural products (37.1 percent to 47.2 percent) and manufactures (56 percent to 62.4 percent); for Poland, mineral fuels (32.5 percent to 54.5 percent) and manufactures (46.5 percent to 59.7 percent); and for Romania, mineral fuels (0.7 percent to 5.6 percent) and agricultural products (40.1 percent to 52.9 percent).

Table 6: Share of the CEE-5 in German Imports, by Major Product Categories, in 1989 and 1991, and the Percent Change in Share between 1989 and 1991

	BULGARIA			CZECHOSLOVAKIA			HUNGARY		
	1989	1991	Change in percent	1989	1991	Change in percent	1989	1991	Change in percent
Foods and Feeds	0.14	0.18	36	0.46	0.52	13	1.01	1.31	29
Raw Materials	0.08	0.11	46	1.02	0.87	-15	0.58	0.67	16
Ores & Non-Ferrous Metals	0.06	0.24	309	0.36	0.92	153	0.47	0.52	11
Mineral Fuels	0.02	0.02	-5	0.99	0.60	-40	0.32	0.26	-18
Manufactures	0.05	0.07	21	0.43	0.84	94	0.49	0.63	30
Total all commodities	0.07	0.08	28	0.49	0.79	60	0.53	0.66	25
	POLAND			ROMANIA			CEE-3		
Foods and Feeds	1.38	1.50	9	0.15	0.12	-21	2.85	3.32	17
Raw Materials	0.85	1.44	70	0.31	0.10	-66	2.45	2.98	22
Ores & Non-Ferrous Metals	1.96	3.94	101	0.46	0.12	-75	2.79	5.38	93
Mineral Fuels	0.80	1.16	44	0.03	0.03	10	2.10	2.01	-4
Manufactures	0.49	0.92	87	0.36	0.22	-37	1.41	2.39	69
Total all commodities	0.71	1.13	59	0.30	0.19	-38	1.73	2.58	49

Source: See Table 1.

As a result of the export expansion between 1989 and 1991, the competitive position of the CEE-5, except for Romania (whose share fell in all product categories except for its traditional exports of oil), improved considerably in German markets for all major product categories with the exception of mineral fuels.

As can be seen from Table 6, the troika's share in total German imports increased by almost 50 percent, mainly thanks to exports of manufactures. The FCSK's share in German imports of manufactured products almost doubled, Poland's share increased by 87 percent, and Hungary's by 30 percent. Bulgaria, whose exports to the OECD stagnated in the 1989-91 period, increased its share in German markets by 28 percent.

The major item in the manufactures export drive to Germany was machinery and transport equipment. Czechoslovak exports of machinery and transport equipment (SITC. 7) to Germany increased by 565 percent (from $101 million to $663 million) and to other EC-10 countries (excluding Germany) by 36 percent (from $256 million to $347 million); Polish machinery and transport equipment exports to Germany increased by 254 percent (from $131 million to $464 million) and to other EC-10 countries by 4 percent (from $340 to $347 million); and Hungarian exports of machinery and transport equipment to Germany increased by 146 percent (from $229 million to $564 million) and to other EC-10 countries by 55 percent (from $128 to $199 million). These exports were previously absorbed mainly by the FSU.

The expansion of trade with unified Germany was apparently not related to commercial links inherited from the GDR's membership in the CMEA. Except for contracts between the former GDR and the FSU, all ties between the GDR and other CMEA members were severed and orders canceled. The dismantling of the CMEA soft p ents mechanism at the end of 1990 precipitated the collapse of trade between the former GDR and the CEE-5; CEE-5 importers were no longer willing to spend scarce foreign exchange on goods produced in firms of the former GDR.

The 1990 and 1991 export drive to Germany allowed producers from the CEE-3 to regain market shares they lost in the OECD countries during the 1980s. Hungary regained its 1980 peak share in OECD imports in 1989, and the FCSK did so in 1992. Despite its impressive growth in 1990 and 1991, Poland's share in 1991 was still slightly lower than it was in 1980.

V. THE REVERSAL IN CEE-3 EXPORT PERFORMANCE: SOME PRELIMINARY HYPOTHESES

As argued earlier, the reversal in CEE-3 export performance trends in OECD markets cannot be attributed to a better match between CEE-3 investment strategies and import demand in international markets, because increased exports came from productive capacities created under central planning. Neither can it be explained by a sudden upsurge of OECD import demand, because CEE-3 producers outperformed other suppliers and significantly increased their market shares. No massive transfer of state-owned assets to the private sector took place in 1990 and 1991, so the improvement cannot be attributed to privately-owned firms, more responsive to market signals. Therefore, one should look for explanations in reforms influencing the behavior of economic actors, changes in external opportunities, and incentives to export. The objective of this section is to identify links between domestic and external circumstances, on the one hand, and export

performance in OECD markets, on the other. The results are tenuous at best, however, as all policy variables were in a state of flux during the initial stages of the transition from central planning.

The major external factor was the collapse of the CMEA, which increased the proportion of aggregate output no longer demanded in CMEA markets. Goods previously exported to the CMEA became available for domestic consumption and/or export to other trading partners; in the extreme, production capacities for unwanted goods would be shut down.[14] The major changes in domestic circumstances were the liberalization of prices and restrictive monetary and fiscal policies, together with the introduction of changes in the incentive structures for SOEs (which remained dominant economic actors during the initial stage of the transition). These measures produced a shift from a supply- to a demand-constrained economy, to borrow an apt phrase from Janos Kornai, and led to a dramatic change in the domestic demand structure--a very significant contraction of demand for some products and some increases for others. The net result, however, was a fall in aggregate domestic demand.[15] The combination of these changes with the introduction of limited current account convertibility and liberalization of the foreign trade regime provided incentives to domestic firms to look for markets abroad.

A. The Collapse of the CMEA

For the period under discussion, the collapse of the CMEA was the only external event with potentially significant implications for Central European exports to the OECD. Although the change in the political status of the region vis-a-vis the West clearly had a positive impact on its export performance in 1990 and 1991, this cannot explain the dramatic shift in export patterns. The region's access to OECD markets did not improve dramatically, although the extension of GSP (Generalized System of Preferences) treatment to Central European countries played some role.[16] (it was irrelevant for Romania which had had GSP status,

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[14] As long as the CMEA-TR settlements mechanism existed, there was also another temporary option: a government might subsidize its domestic producers by running a trade surplus in TRs, thereby subsidizing another country (or reducing its non-convertible currency debt). This option was pursued by the Polish government in 1990, mainly in its trade with the FSU.

[15] For a summary of factors contributing to the fall in aggregate output in Central and Eastern Europe, see Blejer and Gelb (1992:1-3).

[16] The EC granted GSP to Hungary and Poland in 1990, and to Czecho-Slovakia and Bulgaria on January 1, 1991. Although all GSP schemes granted unilaterally by industrial countries exclude major textile and clothing products in which the CEE-5 have comparative advantage (Erzan, Holmes and Safadi, 1992:26), EC quotas for imports from the CEE-5 were significantly raised. In addition, thanks to the GSP status, the simple average tariff on CEE-5 imports significantly declined from around 8 percent in 1988 to 1 percent in 1991. Calculated from the UNCTAD-World Bank SMART (Software for Market Analysis and Restrictions on Trade) data base.

albeit with many special restrictions, since 1971, Schumacher and Mobius, 1992:2). The elimination of quantitative restrictions maintained by the EC against Poland improved its market access.[17] Barriers to the CEE-3 economies' traditionally competitive exports, iron, steel, textiles, clothing and agricultural products, remained in effect in 1991, although they were not binding.[18] The European Association Agreements signed with the CEE-3 in December 1991 were also not relevant for the 1990-91 period, because their provisions were to be phased in over the 10 years beginning in 1992.[19] Finally, the granting of MFN status by the United States did not have a significant impact; Hungary had MFN status throughout the period under consideration, while Bulgaria and the FCSK obtained it in 1991; Poland's MFN status in the United States was restored in 1989, but its trade with the United States accounted for less than 5 percent of its total trade; and Romania's MFN status was suspended in 1988, but its exports were already collapsing for domestic reasons. Hence, among possible external factors accounting for shifts in trade patterns and improved export performance in OECD markets, the collapse of the CMEA was the most relevant event in the 1990-91 period, overshadowing the disappearance of East-West political divisions in Europe.

The problem of adjustment to changing conditions within the CMEA emerged much earlier than in 1990. The official dissolution of the CMEA was the result, not the cause, of the rapidly declining Soviet capability to sustain "soft" settlements in intra-CMEA trade. Thanks to the falling oil price in intra-CMEA trade, most CEE-5 countries began to run trade surpluses with the FSU in non-convertible TRs in 1988. As a result, trade-related debts to the FSU accumulated by CMEA partners between 1975 and 1987 were "... suddenly wiped out by 1988" (Lavigne, 1990:36). The erosion of Soviet ability to pay for imports forced other CMEA governments to introduce various measures restraining exports to the FSU and encouraging exports to hard-currency markets. With the collapse of the Soviet ability to maintain TR payments arrangements in 1990, CMEA members began switching from TRs to hard currencies in their internal transactions, which eventually led to the formal dissolution of the CMEA internal settlements mechanism on

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[17] This decision coincided with the introduction of the Economic Transformation Program on January 1, 1990. In addition, the non-specific quantitative restrictions were suspended until December 31, 1991.

[18] Bilateral quotas imposed by the EC on imports from Central/Eastern Europe were not very restrictive, and their number had declined already between 1985 and 1989. For instance, the number of Multi-Fiber Arrangement (MFA) quotas fell from 71 in 1985 to 54 in 1989, and around 30 percent of them had a quota utilization rate lower than 90 percent (See Erzan and Holmes, 1992). The importance of quotas for other products was also limited because they were rarely utilized (Rodrick 1992:28).

[19] Since the free trade provisions of "Europe Agreements" became effective on March 1, 1992, the CEE-3 has obtained duty-free access to EC markets for a wide range of manufactures. For instance, imports of more than 50 percent of Polish manufactured goods are not subject to barriers (Nogaj, 1992). For a discussion of the Agreements, see Pohl and Sorsa, 1992.

January 1, 1991.[20]

The level of vulnerability to the collapse of CMEA trade was not uniform among the CEE-5, and the extent of the shock from the collapse of CMEA trade was also less abrupt than official statistics might suggest. Since the 1960s, CEE-5 trade with the OECD had tended to increase faster than CMEA trade, despite declining international competitiveness in manufactures. In the 1980s, the quality of CEE-5 manufactures and their international competitiveness was lower than it was in the 1970s (Poznanski, 1988:46-52). The declining international competitiveness of CEE-5 manufactures forced them to offer industrial products at heavily discounted prices, which in turn implied a substantial devaluation of the TR relative to the US dollar. The revalued trade figures suggest a long-term trend of declining shares of the CMEA in CEE-5 total exports. Between 1970 and 1990, this share fell from 76 percent to 54 percent for Bulgaria, from 64 percent to 37 percent for the FCSK, from 62 percent to 31 percent for Hungary, from 60 percent to 39 percent for Poland,[21] and from 50 percent to 24 percent for Romania.[22] Hence, although the CMEA and the FSU were the major trading partners of the CEE-5, a significant redirection of trade to the non-CMEA markets occurred prior to 1990. Still, the CEE-5 countries were extremely vulnerable to economic developments in the FSU as the FSU was their single largest trading partner. The Soviet portion of intra-European CMEA trade was around 70 percent between 1987 and 1990 and 74 percent in 1991, despite the contraction in Soviet imports and exports.[23]

Table 7 shows ratios of CMEA (excluding the former GDR and non-European members) exports to OECD exports for the CEE-4 (excluding Bulgaria[24]). The changes in ratios over the 1987-91 period show that efforts to orient trade away from the CMEA were quite successful and that a dramatic realignment of

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[20] By the end of 1990, around 50 percent of CMEA trade was conducted in hard currency, though the proportion varied for individual countries (Rosati, 1992).

[21] The share of the former CMEA in Poland's exports (in current prices) fell to 16.9 percent of the total in 1991, with the FSU accounting for 11 percent, and Czechoslovakia for 4.7 percent.

[22] For revalued estimates of trade of the CEE-5 and the FSU, see Pohl and Sorsa (1992).

[23] Calculated from data in IMF Direction of Trade Statistics Yearbook, 1992. Non-European members of the CMEA included Cuba, Mongolia and Vietnam. The figures do not include Bulgaria, for which no data on the trade with the Soviet Union are available in the IMF statistics, or the German Democratic Republic, which ceased to exist as a state.

[24] Bulgaria's trade was more oriented toward the FSU than the other CEE-5. The ratios were as follows: 1988 - 5.3; 1989 - 5.1; 1990 - 3.6; 1991 - 2.0. Because these data are derived from other sources, they are not included in Table 7. The tendency is the same as for other countries, although the decline was mainly the result of the collapse of CMEA exports (they fell from US$4.8 bill. in 1988 to US$2.0 bill. in 1991), and stagnating exports to the West (their value rose slightly from US$900 million to US$1 billion in 1991).

export patterns has taken place since 1987.

Table 7: Ratio of CMEA Exports to OECD Exports, 1987-91

	Czechoslovakia	Hungary	Poland	Romania	Memorandum: Standard deviation	CEE-3
1987	2.20	1.18	0.82	0.95	0.54	1.33
1988	2.04	0.99	0.91	1.13	0.45	1.25
1989	1.73	0.78	0.81	1.06	0.38	1.06
1990	1.01	0.49	0.64	0.85	0.20	0.68
1991	0.56	0.41	0.51	0.58	0.07	0.49

Source: IMF, Direction of Trade Statistics Yearbook, 1992.

Table 8 provides additional information relating to the switch from CMEA to OECD markets. It presents the annual changes in the value of exports of the CEE-3 and Romania in 1990 and 1991, as well as between 1987 and 1991 (the period over which the value of intra-CMEA exports was falling), to the FSU,

Table 8: Changes in Value of CEE-4 Exports to FSU, CEE-4, and OECD, 1990 and 1991 (million US $)

	Czechoslovakia			Hungary			Poland			Romania		
	1990	1991	Total 1988-91	1990	1991	Total 1988-91	1990	1991	Total 1988-91	1990	1991	Total 1991-88
FSU	-1398	-898	-2910	-482	194	-1001	78	335	1081	-1025	-572	-1309
CEE-4	-745	-232	-1007	-243	-236	-598	498	-834	-67	-632	-310	-1164
OECD	661	1685	2910	1152	940	2856	2557	1110	4845	-1097	-387	-1791
TOTAL	-1481	556	-1007	427	898	1257	3133	611	5859	-2754	-1269	-4264
Memorandum: FSU: Balance of Trade												
FSU:	-152	+1054		-442	-485		-1282	-1410		+687	-57	

Source: IMF, Direction of Trade Statistics Yearbook, 1992

to other European CMEA members, and to OECD countries (EC, EFTA, North America and Japan). Two points are worth noting. First, the increase in exports of the CEE-3 economies to the OECD more than offset the fall in exports to former CMEA markets.[25] Second, there were significant differences in export performance among the CEE-5 economies. Poland stands out. Its exports to the FSU increased in both 1990 and 1991, while exports from other countries fell, and the annual increases in 1990 and 1991 followed expansion in both 1988 and 1989. The overall increase between 1987 and 1991 was slightly above US$1 billion. It should be noted that while the data on intra-CMEA trade until 1990 suffered from problems related

[25] Although the amounts offset each other, the terms of trade and budgetary implications are different. The collapse of intra-CMEA trade and the switch to world prices contributed to government budget deficits in the CEE-5, as a study on Hungary demonstrates (Abel, Hillman and Tarr, 1992).

to converting ruble-denominated trade flows into US dollars,[26] this was not the case in 1991 when around 98 percent of all transactions were carried out in hard currency (UN ECE, 1992:85). In consequence, the data for 1991 provide a statistically less distorted image of the realignment in export patterns.

B. The Redirection of Former CMEA Sales to the OECD

This section addresses the extent of diversion of exports from the CMEA to the OECD. While more research is needed, some preliminary observations concerning the reorientation of exports can be derived from examining changes in Poland's exports in 1990 and 1991 (i.e., when an almost complete switch to hard currency settlements in intra-CMEA trade occurred), and in Hungarian and Polish exports of selected manufactures to the FSU and the EC.

Although countries experiences varied according to their former involvement in specialization schemes within the CMEA, we would argue that the pattern of change in Hungary's and Poland's trade has been shared by other former CMEA members. Their economies were under broadly similar administrative economic systems, they all pursued similar inward-oriented development strategies, and they all were part of the radial pattern of industrial specialization organized around the FSU. Further, within the CMEA trading area, they all sought to minimize exports of hard currency earners and maximize exports of goods which could not be sold in international markets.

According to conventional wisdom, CEE-3 exports of manufactured goods to the CMEA, especially to the FSU, consisted of "soft" goods noncompetitive in world markets because of high production costs and low quality (Marrese and Vanous, 1983). Since in the short term the quality could not be significantly improved, the only means available to producers of soft goods to sell them in international markets was to offer them at heavily discounted prices. However, there were two obstacles to this course of action. First, the trade-off between low prices and product quality was limited: even huge price cuts may not have attracted customers. Second, by 1991 producers in the CEE-3 performed in a new environment where financial performance became linked to sales revenues. So they could no longer ignore world prices. For these two reasons, the capacity of SOEs to compete through price discounts was eroded. Therefore, one would expect a very limited redirection of exports of manufactures from the CMEA to the OECD.

This expectation is borne out by Rodrick (1992) who used the change in the product composition of industrial exports by area in 1985 and 1990 as a proxy measure of the extent of the switch in exports by Poland (and Hungary) following the radical opening of the economy in January 1990. The composition of

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[26] For a concise discussion of the major problems involved, see Chapter 2 in Economic Bulletin for Europe, Vol. 42/90, pp. 29-31.

CEE-5 exports to the CMEA and to the OECD was traditionally strongly dissimilar, the former having a large component of capital equipment and electrical engineering equipment, with the latter being dominated by raw materials and energy. Rodrick concludes that "... there is no evidence that the overall increase in trade with the West was fueled by redirecting Eastern sales to the West, or indeed that the latter played any role at all in the former" (Rodrick, 1992:18).

While some developments in 1991, after the switch to convertible settlements in the former intra-CMEA trade, seem to support Rodrick's conclusion, a different picture emerges when taking 1985 as a frame of reference and focusing on the electrical engineering industry. For example, in support of Rodrick, in 1991, as compared with 1990, the product composition of Polish exports to former CMEA countries became significantly more similar to the product composition of its exports to other destinations.[27] Faced with convertible currency constraints after the termination of the TR-payments mechanism, importers from the former CMEA slashed soft goods in favor of hard goods, independently of their origin. Indicative of this switch was the increase in imports of the same products which had been successfully marketed in the OECD by Polish firms.

Comparison of Polish industrial exports to the CMEA and the EC in 1985 and 1991, however, suggests that the industrial product structure of exports to the EC shifted towards that of the CMEA. For instance, the share in Polish exports of the electrical engineering sector almost doubled, from 11.3 percent in 1985 to 22 percent, as its exports (in current prices) to the EC increased almost five-fold, while its share of exports to the CMEA fell from 63.8 percent to 45.3 percent. Products of the electrical engineering sector--machine tools, heating and cooling equipment, mechanical handling equipment, etc.[28]--were among manufactures which contributed most to the export expansion in the EC. Without a detailed analysis at the micro-level, it is impossible to tell whether the SOEs dominant in TR trade were also those who managed to increase exports to other markets.

The redirection of exports of power generating equipment from the CMEA to the EC is illustrated in Table 10. Power generating equipment, the main product category of the electrical engineering sector, accounted for a significant share of Hungarian and Polish industrial exports to the FSU. (Exports to other CMEA countries are not taken into account because the share of "hard for soft goods" transactions was much

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[27] The index of similarity between the two structures (which assumes 1 for full similarity and 0 for complete dissimilarity) rose from 0.715 in 1990 to 0.896 in 1991. The index for 1991 was calculated for the same breakdown used by Rodrick (1992:18 and 46). In addition, I calculated the index of similarity between product compositions of exports to the former European CMEA and the ECE: the index rose from 0.621 in 1990 to 0.819 in 1991. For a more detailed analysis, see Kaminski (1993).

[28] For an extensive discussion, see Kaminski (1993).

smaller in their mutual trade than in their trade with the FSU.) The change in export patterns of the two countries displays some similarities: Hungarian exports to the FSU peaked in 1987, while Polish exports peaked in 1988; in the 1985-91 period the value of Hungarian exports to the EC increased almost five times, while Polish exports increased almost 3.5 times; the largest increase in Hungary's and Poland's exports to the EC, which occurred in 1990, coincided with the largest fall in exports to the FSU (the EC absorbed 57 percent of the fall in Hungarian exports to the FSU and 106 percent of the fall in Polish exports to the FSU); as a result, the ratio of Hungarian exports to the FSU to exports to the EC fell precipitously from 7.3 in 1985 to 0.41 in 1991, while the ratio for Poland decreased from 7.0 in 1985 to 0.38.

The degree of redirection of Hungarian and Polish exports of power generating equipment from the CMEA to the EC may be inferred from two indexes: first, the ratio of the increase in the value of exports to the EC to the decrease in the value of exports to the FSU between the peak year of exports to the FSU and 1991; second, the ratio of the total annual changes in the value of exports to the two partners in the 1985-91 period. These ratios are: 49 and 66 percent for Hungary; and, 33 and 45 percent for Poland. They suggest that the scope of redirection was larger for Hungary (between one half and two thirds of the fall in FSU imports compensated by the increase in EC imports) than for Poland (between one third and close to one half). These measures should be t d with extreme caution, however, because of the use of different implicit crossrates between the TR and the US dollar in the period under consideration.[29] For instance, in 1990 the crossrates used in both Hungary and Poland significantly increased, thus depressing the dollar value of exports to the FSU. Thus, the value of earlier exports to the FSU was probably overstated, and so was the contraction in 1990. As a result, the scope of redirection of Hungarian and Polish exports of power generating equipment to the EC might have been actually larger than indicated by these two measures.[30]

This "transformation" of soft goods into hard goods was possible thanks to EC demand (which could not be met earlier because of obligations vis-a-vis the CMEA partners), greater concern for quality control, low wages, subsidies (as OECD producers often complain[31]), or a combination of the above.[32] But the

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[29] For an extensive discussion of statistical problems involved, see Economic Bulletin for Europe, Vol 43, pp.59-62.

[30] While no data are available in the UN COMTRADE data base for Czecho-Slovakia, mirror statistics show a very considerable increase in exports of SITC.Rev 1.71 to the EC from US$167 million in 1989 to US$396 million in 1991. It is clear that reorientation played an important role in the increase.

[31] West European producers of steel are particularly vocal in criticizing CEE-5 steel makers for undercutting prices through subsidies (Ostry, 1993:12). Clearly, energy-intensive exports were subsidized through central controls over prices of oil and electricity in 1990. In 1991 this was not the case, however.

experience of the former east Germany's exports suggests that among these factors low wages are crucial. Although east German industry was regarded as the most technologically sophisticated within the CMEA, no redirection of exports has so far occurred despite the generous export guarantees provided by the German government. Total exports contracted in 1991 by 53 percent and had it not been for export guarantees to the FSU, the decline would have been much more significant.[33] This situation can be attributed mainly to loss of competitiveness triggered by large increases in east German wages (in 1991 they were around 70 percent of the Western level). As Dornbusch and Wolf (1992:239) observe: "The eastern German productivity level resembles Mexico's or Korea's, while the wage level matches that of the United States and is ten times greater than that of the neighboring Czech and Slovak Federal Republic." A competitive disadvantage, the result of much lower productivity in east German industries and much higher unit wage costs, could not be offset by quality advantages.[34]

Table 9: Changing Orientation of Hungarian and Polish Exports of Power Generating Equipment Exports (SITC. 71) from the FSU to the EC between 1985 and 1991 (million US$)

Years	Hungary				Poland			
	FSU	EC	Subtotal	Share of EC (in percent)	FSU	EC	Subtotal	Share of EC (in percent)
1985	518	71	589	12	759	108	864	12
1986	500	100	600	17	619	120	740	16
1987	549	121	670	18	559	154	713	22
1988	468	154	622	25	722	194	916	21
1989	434	176	609	29	653	235	888	26
1990	294	257	550	47	524	370	894	41
1991	133	325	458	71	147	386	533	73

Source: The United Nations COMTRADE data base, as reported by Hungary and Poland.

Thus, one may conclude that the troika export expansion was to some extent propelled by redirection of sales from the CMEA to the EC.[35] The improvement in competitiveness may be precarious, however. The loss of momentum in Polish exports of electrical engineering products in 1991 may indicate that

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[32] One caveat should be made: without a detailed analysis at the firms level, it is also impossible to assess whether exports diverted from the FSU were profitable or represented "distress sales," i.e., at prices below production costs.

[33] See Focus Germany, Deutsche Bank Research, March 1992

[34] According to the Institute for Economic Research in Halle, the unit wage cost was around 70 percent higher than in west Germany. As the authors of a report emphasize, this situation is hurting east German competitiveness because it is not "... neutralized with quality advantages" (Focus Germany, Deutsche Bank Research, March 1992:4).

[35] Richter (1992) draws a similar conclusion from the analysis of change in Hungarian trade patterns.

improvement was partly due to subsidized energy prices in 1990. An enterprise-level assessment of redirection of trade would shed some light on the potential for export growth in the near future. The available evidence indicates that enterprises which had specialized solely in exports to the FSU and other CMEA countries did not have much success in redirecting their exports to other markets. For instance, the driving force behind Poland's export expansion in 1990 were the SOEs which had earlier exposure to Western clients and whose previous involvement in intra-CMEA trade was not significant, as a recent World Bank study forcefully argues (Mueller, 1991).

C. Impact of the Switch from a Supply- to a Demand-Constrained Economy

The analysis in Sections III and IV of this study shows the dramatic difference in foreign trade performance between the most reformed Central European troika and the Balkan countries. It suggests that countries which decontrolled prices as well as liberalizing their trade regime, bringing exchange rates closer to market-based levels, and introducing unified exchange rates, succeeded in increasing exports to the OECD. No matter how liberal the trade regime or how strong or weak the domestic currency, improvement in export performance was the result of a shift from administrative rationing to market clearing prices--i.e., to the transition from a supply- to a demand-constrained economy. Despite the liberalization of their foreign trade regimes, Bulgaria and Romania were crippled by macroeconomic chaos and wavering microeconomic reforms and registered falls in exports.

By the end of 1991, external trade regimes had been dramatically liberalized in CEE-3 countries.[36] They had all adopted currency convertibility, following a similar set of steps including legalization (or quasi-legalization) of black market activities, liberalization of domestic prices and unification of exchange rates. They had all introduced tariffs, rules of customs valuation and anti-dumping procedures which were more or less compatible with GATT standards. And in all CEE-3 countries firms could decide what they wanted to import and/or export, and they had the right to buy foreign currency at the official exchange rate in order to import goods or services from abroad. As a result, tariffs and exchange rates became effective trade policy instruments.[37] Table 10 summarizes the institutional features of the convertibility and foreign trade regimes of the CEE-3 as at the end of 1991.

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[36] Ironically, the only products for which quantitative restrictions were initially maintained were those subject to quotas, VERs, etc. imposed on them by the EC, the United States and other trading partners (Rodrick, 1992).

[37] Their impact on firms' behavior may be weakened by the extent to which SOEs operate under a soft-budget constraint. This is still the case for many SOEs in all post-communist economies, especially for the large ones which, because of size, have strong political clout.

In the arena of domestic transformation policies the timing of their launching and their scope varied among the CEE-5. The differences in institutional circumstances in Hungary, Poland and the FCSK set the troika apart from Bulgaria and Romania.[38] Poland moved from a supply- to a demand-constrained economy in January 1990, and the FCSK in January 1991. The transition to a market economy in Hungary was more gradual, and a specific date cannot be given.[39] Bulgaria made significant strides in this direction throughout 1991, while Romania was still in an "institutional vacuum" in mid-1992. The two Balkan countries offer some indications as to the impact of the loss of central macroeconomic controls on export performance in a shortage economy: this inevitably leads to the collapse of exports no matter how liberal a trade regime may become.[40] On the other hand, the impressive gains made by the FCSK, Hungary and Poland in OECD markets demonstrated the strong link between radical economic reforms and export performance. For the FCSK and Poland, the link is striking when the dates of implementing the economic transformation programs are juxtaposed with their export growth statistics. During the first year of the transformation programs, Poland increased its exports to the OECD by 43 percent and the FCSK by 37 percent.

The major domestic changes which encouraged exports on the basis of comparative advantage for the CEE-3 countries included the contraction in domestic economic activities as a result of restrictive monetary and fiscal policies, th eralization of prices, and the granting of significant autonomy to SOEs. These reforms were undertaken by the troika countries in 1990 and 1991. Another factor which had a bearing on their export performance was earlier commercial links between SOEs and the OECD.

Even though all CEE-3 economies carried out these reforms in general terms, differences of detail existed. These stemmed largely from the differences in economic conditions preceding the collapse of the communist regimes. Hungary, with many market institutions already in place before the collapse of communism, was able to continue its evolutionary path; the FCSK, which had a relatively balanced and

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[38] Having gone through a different political cycle following the collapse of communist regimes, Bulgaria and Romania began transforming their economic systems only in 1991. In both countries, the first free elections held in 1990 brought about the victory of former communist parties. The former communist party lost its majority in the Bulgarian parliament in the second elections in the fall of 1991, and, as a result, the reform process has acquired a greater degree of political credibility.

[39] In September 1990 the Hungarian government adopted a three-year transformation program, spelling out the major measures that would reduce direct government intervention in the economy, expand the role of the private sector, further liberalize prices, and provide a gradual adjustment of the financial sector to the market "rules of the game."

[40] This is not a new finding. Neither is this phenomenon currently limited to Bulgaria and Romania. The link was amply illustrated by the Polish experience during the Solidarity period in 1981 (Poland's share in OECD imports dropped by 31.4 percent). The current fall in the foreign trade of former Soviet republics is in part related to the same phenomenon.

centralized economy, did not need very restrictive stabilization policies (some would argue that the policies chosen were unnecessarily restrictive, see Blejer and Gelb, 1992); while Poland, which suffered from severe domestic imbalances exacerbated by the significant autonomy given to SOEs, required radical stabilization policies.

Reactions by CEE-3 firms to policy changes were not expected to be "normal" market reactions, given the institutional fluidity within these countries and the limited role of the private sector in the initial phases of the transformation process. Yet the response to the breakdown of the state monopoly of foreign trade and the introduction of current account convertibility was a dramatic increase in the number of firms involved in foreign trade activity, a seemingly normal reaction. The link between imports, domestic aggregate demand and the real exchange rate, which barely existed under central planning, was established under the economic transformation measures. Import decisions became responsive to price relationships between domestic and foreign goods.

However, some responses may strike one as perverse, i.e., non-textbook responses. For instance, a simple comparison of monthly real exchange rates with monthly convertible currency exports suggests that the appreciation of the Polish zloty was not accompanied by a contraction of exports in 1990.[41] Similarly, neither in the FCSK nor in Hungary did the significant appreciation of their currencies throughout 1991 trigger a fall in exports. On the contrary, exports increased significantly at a time of increasing domestic costs and falling foreign prices.[42] The initially low sensitivity of SOE managements to profit considerations can be explained by the fact that these pressures were somewhat attenuated by government subsidies of SOEs,[43] as well as by expectations that "things will soon become ab-normal again." Also, many SOEs held very

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[41] A regression with monthly convertible currency imports as the dependent variable and aggregate expenditures and the real exchange rate as independent variables (accounting for a seasonal variation) for the 1988-89 and 1990-91 periods yields the following results: weak relationships between imports and the real exchange rate and domestic expenditures for the period before the "big bang" of 1990, and strong ones for the 1990-91 period (Michalek, 1992).

[42] Although all CEE-3 governments devalued their domestic currencies in 1990 and 1991, the devaluations tended to be less than the inflation rates, thus leading to a revaluation in real terms. The "big bangs" in Czecho-Slovakia and Poland were accompanied by a significant depreciation in the real exchange rates, subsequently eroded by inflation. The devaluation-inflation gap was particularly acute in Poland throughout most of 1990 and until May 1991 (Winiecki, 1991), and in Hungary in 1991 (Denton, 1992). The gap was much less severe in Czecho-Slovakia,where monthly inflation rates peaked in early 1991 (Rodrick, 1992).

[43] The degree and modes of subsidization varied across countries. But during the initial stage of the transformation, they all had one thing in common, namely, since most state-controlled prices were below world market levels, export of these products or of products with a high content of inputs subject to price controls was in fact subsidized. This was the case for exports of energy-intensive goods.

significant stocks of raw materials and intermediate products,[44] they had accumulated stocks of convertible currencies under the export earnings retention scheme (used in Bulgaria and Poland), and they had easy access to credits and subsidies. Under these circumstances, the restraints on money supply affected the liquidity position of households and private firms[45] but not that of SOEs cushioned by the "old" system. Another consideration is that the dwindling domestic demand might have pushed some SOEs to engage in discounting prices below full production costs. These "distress sales," also experienced by private firms in market economies during an economic downturn, may have contributed to the weaker sensitivity of SOEs to the exchange rate policy.

It is impossible to link specific policy variables with export performance in the circumstances peculiar to each country. There are too many variables, and they were changing too rapidly throughout the 1990-91 period. Yet two broad sets of circumstances were shared by exporters in the CEE-3. First, the shift to a demand-constrained economy was accompanied by a fall in aggregate output and domestic demand. We have no reliable data on the developments in domestic absorption, but the downturn in domestic demand as proxied by the Net Material Product (NMP) and industrial output was quite significant. During the first year of the transformation program in the FCSK, the NMP fell by 20 percent and industrial output by 23 percent. In Hungary, the NMP was 11 percent lower and in Poland 23 percent lower in 1[illegible] than in 1989, while industrial output was 23 percent and 33 percent lower, respectively.[46]

It is interesting to note the correlation between the contraction in domestic aggregate activity and the growth of exports to OECD markets (measured by the increase in the share of OECD imports). The relationship is somewhat obscured by the Czechoslovak performance: the FCSK's increase in OECD import share in 1991 was smaller than Poland's, but the fall in industrial output and national income during the first year of the transition program (by 16 percent and 22 percent, respectively) was slightly larger then in Poland (13 percent and 23 percent, respectively). This slight difference between the Polish and Czechoslovak cases might have been due to several factors: the above-mentioned alleged macroeconomic overkill at the outset of the transformation program in the FCSK; greater dependence of the FCSK on trade with the FSU; and

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[44] Because of the unreliability of supplies and persistent excess demand for their products, the SOEs tended to maintain high inventories of inputs rather than of finished products. For an extensive analysis, see Kaminski (1991:Ch.2).

[45] A comparison of real changes in households' and SOEs' deposits suggests that this was the case in Poland in 1990. It may be worth adding that this situation continued in 1991 (for more discussion on this point, see Winiecki, 1990:765-790).

[46] See Tables 3.2.3 and 3.2.6 in UN, ECE 1992.

Table 10: A Summary of Convertibility and Foreign Trade Regimes in the CEE-3 (end of 1991)

Institution responsible for setting exchange rate	Exchange Rate Regime	Pegged Currency	Access to Convertible Currency Markets	Export Measures	Tariffs	Licensing & Import Quotas
Czechoslovakia						
Council of Ministers. National Bank sets the exchange rate within +/-10% of the official rate.	Fixed	Currency basket (DM accounts for 45.5%)	Purchase unlimited. Firms can buy CC in banks. Individuals entitled to $175 per year.	No taxes and subsidies. Around 20% of exports subject to licensing (covers weapons, essential inputs and VERs).	Average around 5%. A temporary import surcharge of 15%. Around 96% is GATT-bound.	No quantitative controls. Few import licenses covering weapons, drugs, etc.
Hungary						
Planning Committee of Council of Ministers. National Bank sets the exchange rate within+/-5% of the central rate.	Crawling	Currency basket (50% US$, 50% ECU)	Purchase unlimited. Firms can buy CC in banks for foreign trade transactions. Individuals entitled to $50 per year.	Subsidies on some agricultural products. Restrictions related to OECD nontariff restrictions.	Average around 13%, but other charges (5-6% ad valorem).	Licenses cover around 10% of total imports. 100% advance import deposit required.
Poland						
Council of of Ministers	Downward crawl	Currency basket (pre-announced)	Full convertibility for current account transactions.	No taxes and subsidies. Export quotas related to OECD restrictions and selected inputs.	Average around 14%. All procedures in line with GATT articles.	No restrictions except for alcoholic beverages.

Sources: Jan J. Michalek, The Opening-Up of the Polish Economy, PPRG Discussion Paper #11, University of Warsaw, December 1991; Dani Rodrick, Foreign Trade in Eastern Europe's Transition: Early Results, NBER, mimeo, January 1992; and Gazeta Bankowa, No. 44, 11.03-11.09.1991.

initially, the less-developed commercial links of Czechoslovak SOEs with OECD importers. (The last factor was due to the stringent monopoly of foreign trade in the FCSK in the 1980s, see Section II). Hungary, which adopted the most cautious approach, experienced the lowest decline in GDP, and had the lowest increase in OECD market share among the CEE-3. These relationships between export expansion and the contraction in aggregate economic activity point to the domestic demand slump as an important determinant of export performance.

The second set of circumstances shared by the CEE-3 economies was that the emergence of a domestic demand constraint combined with the liberalization of trading regimes created an environment where the incentives to export were strong. Faced with the collapse of consumer demand and devaluation, export expansion became one of the few options available for preventing too drastic a fall in output. Because of the cessation of the CMEA soft payments mechanism, the insolvency of Soviet importers, and the fall in import demand in the former CMEA economies, the only avenue was to expand exports to markets other than the FSU and the CMEA. Surprisingly, given the dominance of SOEs and the obsolete capital stocks in the CEE-5 economies, SOEs from the most reformed CEE-3 economies responded to these challenges, showing very impressive export performance. Enterprises with established links with OECD importers and marketing expertise were clearly in a better position to advantage of this situation.

The primary force behind the impressive export performance of the CEE-3 was the restructuring of their domestic economic systems involving the liberalization of prices and the hardening of budget constraints for SOEs. The reforms made the SOEs more responsive to market signals. By establishing more transparent links between their performance and their financial situation, the reform measures subjected SOEs to a tighter budget constraint. At the same time, the significant liberalization in trade policy exposed the SOEs to foreign competition. As the experience of different CEE-5 economies demonstrates (see section II), however, liberalization of the foreign trade regime has no significant impact on export performance if the economy remains a supply-constrained economy, that is, if the shift to market-clearing prices is not made. In fact, the experience of Bulgaria and Romania in the 1990-91 period shows that a hybrid of quasi-markets and quasi-administrative controls has a disastrous impact on export performance. Thus the key to improved export performance is the shift to a demand-constrained economy accompanied by liberalization of the foreign trade regime.

VI. IS THE EXPORT EXPANSION TO THE OECD SUSTAINABLE?

There are still too many unknowns to be able to give an unequivocal assessment of whether the improved export performance experienced in the first year of the transformation programs in the FCSK and Poland is sustainable. Although the increase in exports to OECD markets was quite dramatic, it does not

necessarily imply a dramatic change in the CEE-3 economies' competitiveness and export potential. Their industrial base, inherited from central planning, has remained unchanged and will not be transformed unless an upswing in output and capital formation takes place. The improvement in exports was impressive but only against the background of the dismal performance in the 1980s. Still, the export boom, driven by manufactures, was an unexpected outcome of the transformation and represented a turnaround in CEE-3 export performance in OECD markets.

The argument in support of seeing the export expansion as only a temporary phenomenon is as follows. The major constraint on the trade performance of the CEE-3 in the 1980s was on the supply side. The removal of this constraint, by replacing an administrative economic system by a market-based one, reduced waste in the use of resources. The fall in consumption led to a temporary increase in export offers. The main source of expanded exports was not diversion from former CMEA markets but the contraction of domestic demand, resulting in distress exports. Expansion of exports will be possible only so long as there is a further compression in domestic demand accompanied by devaluations of domestic currency to ensure profitability of exports.

However, there are grounds for sketching a more optimistic scenario. First, the troika economies continued their export expansion in 1992. For instance, during the first six ıths of 1992, the third year of the transformation program, Polish exports in current prices increased by 12.5 percent (CPO, 1992:1), while the value of Hungarian exports increased by 14 percent for the first seven months of 1992.[47] More significantly, the increase in Polish exports took place against a background of stagnant (not contracting) domestic demand.

Second, the export upswing took place in an institutional environment whose full export potential is yet to be tapped. Two institutional constraints remain. The first relates to the dominance of the state-owned sector. During the initial stage of the transformation, the export push came from SOEs with organizational structures inherited from central planning. Privatization of SOEs, usually preceded by organizational restructuring to make state-owned assets more attractive to potential investors, is likely to increase their capacity to compete in international markets.

The second institutional constraint to export growth relates to the absence of organizations providing information and credits for export-oriented activities. While the absence of export-promoting infrastructure was not particularly relevant for large SOEs with an earlier presence in OECD markets, it may hamper exports by newly-established private firms. The problem is that they are usually small and seldom have information capabilities for identifying export opportunities. In addition, since they lack capital, they tend

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[47] See Transition. The Newsletter about Reforming Economies, The World Bank, Vol. 3, No. 8, September 1992, p. 11.

to trade with geographically close countries, as the experience of small Hungarian and Polish firms illustrates.[48] Their share in exports, though increasing, remains lower than their share in aggregate output. In brief, privatization and organizational restructuring of SOEs together with the development of infrastructure facilitating access to foreign markets may provide strong stimuli to exports.

More research is needed on the following issues to provide an answer to the question of the sustainability of export growth following the introduction of radical transformation programs:

First, the extent to which SOEs successful in marketing their products in the OECD have been affected by the decline in investment activity. The evidence is scarce but there are some indications that export-oriented enterprises face a financial squeeze,[49] and that export performance has not been reflected in higher profitability. If this is so, it is doubtful that export-oriented SOEs have invested in upgrading their production capacities, which will add to the difficulties of privatizing SOEs.

Second, the supply side of the export upswing. Among the questions relevant to the sustainability issue are: what manufactured goods contributed to the export drive of the CEE-3, to what extent did revealed comparative advantages change during the recent export drive, and did exports originate mainly from productive capacities of more recent vintage?

Third, the characteristics of the major CEE-3 export markets, that is, whether these OECD markets are stagnating, contracting, or expanding?

Finally, the impact of rising foreign direct investment in the CEE-3[50] by OECD firms on the international competitiveness of the troika.

VII. CONCLUSION

This paper provides analysis to support the following findings. First, the decision to move quickly to a market-based economy was closely linked with export performance. This is illustrated by the dramatic difference between the export performance of the most reformed Central European troika and that of the

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[48] According to the Hungarian Ministry for International Economic Relations, the growth of small and medium-sized firms engaged in exports was one of the factors accounting for the fall in trade with developing countries (see "Hungary: Foreign Trade," Oxford Analytica, 27 August 1992). Polish private firms also export mainly to EC markets (see CPO-1992 and MWGZ-1992).

[49] For instance, the Hungarian minister of international economic relations, Bela Kadar, noted that SOEs facing bankruptcy exported products worth around US$1 billion in 1991. See Radio Free Europe - Daily Report, June 30, 1992. In 1991 the Polish state-owned industrial sector recorded significant losses, but it is unclear whether the SOEs heavily involved in exports were profitable.

[50] For a statistical survey of foreign investment in Central and Eastern Europe, see East European Investment, June 1992:14-25.

Balkan countries. Countries which liberalized their trade regimes, devalued currencies, introduced unified exchange rates, and removed administrative controls over prices succeeded in increasing exports to the OECD. Romania, crippled by macroeconomic chaos and vacillating microeconomic reforms, registered falls in both exports and imports.

Second, developments in export performance following the implementation of comprehensive transformation programs seem to have had little to do with previous trends in export performance, external economic factors and earlier attempts at trade regime reforms. Pre-transformation export performance offered no clues as to what actually occurred--the export expansion in the 1990-92 period was a dramatic reversal of trends prevailing over the previous two decades. Similarly, the degree to which the administrative economic system was modified before the collapse of communism turned out to be of less consequence for foreign trade than was generally anticipated. The FCSK, which was not at the forefront of reform efforts under central planning and had not sought to expand commercial relations with the OECD, recorded export growth as impressive as Poland's. Thus, neither the length of the "adjustment period" to market institutions and less rigidly controlled foreign trade nor earlier trends in competitiveness in OECD markets explain the increase in exports.

Third, the differences among the troika in export growth to the OECD were positively correlated with the size of contraction in GDP rather than with exchange rate policies. Hungary experienced the lowest decline in GDP, but simultaneously experienced the lowest increase in OECD market share among the CEE-3. The devaluation-inflation gap in the CEE-3 had no significant impact on exports. The domestic demand slump associated with the transformation was the most important determinant of export performance.

Fourth, the severance of links that used to bind economies of the CMEA had a less destructive impact on foreign trade performance than one might expect. Although relationships between intra-CMEA trade and trade with the OECD are still obscure, the simultaneity of the fall in exports to the CMEA and the increase in exports to the West suggests a connection. These developments give an interesting twist to East Europeans' description of the CMEA as a "council for mutual exchange of inefficiencies."

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STATISTICAL APPENDIX

Appendix Table 1: Summary Characteristics of the Export Performance of the CEE-5 in the OECD in 1983-89 and 1990-91.

	Rates of Export Growth to OECD		Average Share in OECD Imports			Index of CEE-5 Exports to OECD Imports (value)		Ratio of CEE-5 Export Index to OECD Import Index		Commodity Composition of CEE-5 Exports		% Change	Country Shares in Total CEE-5 Exports		
					% Change					Average in		in Share	Average		Change in share
	1990 (a)	1991 (b)	'84-89 (c)	'90-91 (d)	in Share (d/c-1) (e)	1989 '83=100 (f)	1991 '89=100 (g)	1989 '83=100 (h)	1991 '89=100) (i)	'84-89 (j)	'90-91 (k)	(i/h-1) (l)	'84-89 (m)	'90-91 (n)	(n/m-1) (o)
CEE-5															
Total Exports	19	16	0.95	0.97	2	169	137	93	115	100	100	---	---	---	---
Foods and Feeds	18	6	1.41	1.63	16	192	126	121	102	15	16	6	---	---	---
Mineral Fuels	-12	-14	1.44	0.84	-41	99	75	130	60	20	9	-54	---	---	---
Ores and Non-Ferrous	8	20	1.33	1.52	14	196	129	107	139	5	6	2	---	---	---
Raw Materials	10	-6	1.67	1.54	-7	150	104	84	110	6	5	-23	---	---	---
Manufactures	29	25	0.74	0.86	16	197	161	85	134	51	62	22	---	---	---
Bulgaria															
Total Exports	22	6	0.04	0.04	-5	129	:	71	109	100	100	---	4	4	-6
Foods and Feeds	25	12	0.11	0.13	17	145	140	91	114	27	31	15	8	8	1
Mineral Fuels	-26	-79	0.05	0.01	-72	46	154	61	12	15	4	-77	3	1	-54
Ores and Non-Ferrous	9	100	0.04	0.05	40	151	218	83	235	4	5	29	3	3	19
Raw Materials	-10	-16	0.05	0.05	0	249	76	140	80	5	4	-13	3	4	6
Manufactures	37	9	0.03	0.03	4	159	149	69	123	47	55	18	4	4	-10
Czechoslovakia															
Total Exports	17	37	0.20	0.22	14	157	160	86	134	100	100	---	21	23	11
Foods and Feeds	9	9	0.15	0.18	16	192	119	121	97	8	8	-3	11	11	1
Mineral Fuels	-14	-6	0.19	0.14	-28	95	81	125	64	13	7	-48	13	16	23
Ores and Non-Ferrous	-1	120	0.13	0.22	68	195	216	107	232	3	4	28	10	14	6
Raw Materials	3	-22	0.65	0.52	-20	146	80	82	85	12	7	-38	39	33	-14
Manufactures	27	49	0.19	0.23	22	170	188	74	156	64	73	15	26	27	4

Appendix Table 1 (cont.): Summary Characteristics of the Export Performance of the CEE-5 in the OECD in 1983-89 and 1990-91

	Rates of Export Growth to OECD		Average Share in OECD Imports			Index of CEE-5 Exports to OECD Imports (value)		Ratio of CEE-5 Export Index to OECD Import Index		Commodity Composition of CEE-5 Exports Average		% Change in Share	Country Shares in Total CEE-5 Exports Average		Change in share
	1990 (a)	1991 (b)	'84-89 (c)	'90-91 (d)	% Change in Share (d/c-1) (e)	1989 '83=100 (f)	1991 '89=100 (g)	1989 '83=100 (h)	1991 '89=100) (i)	'84-89 (j)	'90-91 (k)	(i/h-1) (l)	'84-89 (m)	'90-91 (n)	(n/m-1) (o)
Hungary															
Total Exports	27	17	0.20	0.25	21	191	148	105	124	100	100	---	22	25	9
Foods and Feeds	11	20	0.50	0.57	16	182	133	115	108	25	22	-10	35	35	0
Mineral Fuels	4	12	0.14	0.12	-16	131	117	172	92	10	5	-46	10	14	44
Ores and Non-Ferrous	24	-21	0.26	0.32	21	234	99	129	106	6	5	-8	20	21	8
Raw Materials	14	13	0.33	0.38	16	173	128	97	136	6	5	-20	20	24	27
Manufactures	38	21	0.16	0.21	31	203	167	88	138	53	62	16	22	25	13
Poland															
Total Exports	44	13	0.28	0.37	31	193	162	106	137	100	100	---	30	38	29
Foods and Feeds	35	-8	0.56	0.72	28	234	124	148	101	20	20	-8	40	44	11
Mineral Fuels	25	5	0.44	0.43	-2	98	132	129	105	21	12	-42	31	52	68
Ores and Non-Ferrous	25	22	0.68	0.87	28	166	153	91	164	11	10	-12	51	57	12
Raw Materials	33	3	0.49	0.55	11	142	137	80	145	6	4	-29	29	35	20
Manufactures	58	23	0.17	0.28	63	270	194	117	161	41	54	33	24	33	40
Romania															
Total Exports	-31	-16	0.23	0.09	-60	141	58	77	49	100	100	---	24	10	-60
Foods and Feeds	-57	77	0.09	0.04	-62	109	76	69	62	4	4	-8	7	2	-67
Mineral Fuels	-47	-65	0.62	0.14	-77	102	19	134	15	36	16	-56	43	17	-61
Ores and Non-Ferrous	-62	-18	0.23	0.07	-68	299	31	164	34	5	3	-31	17	5	-72
Raw Materials	-39	-27	0.15	0.05	-67	118		67	47	2	2	-29	9	3	-63
Manufactures	-18	-4	0.18	0.10	-47	168	..	73	65	52	75	-42	24	11	-53

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